

INDIANA DEPARTMENT OF REVENUE

REVENUE RULING #2001-02IT

February 6, 2001

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ISSUE

Gross Income Tax – Agency

Authority: IC 6-2.1-2-2, Rule 45 IAC 1.1-6-10, Rule 45 IAC 1.1-1-2, Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999), Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994)

The taxpayer requests the Department to rule whether or not the reimbursement of wages and taxes paid to, and for, temporary employees represents income received in an agency capacity, therefore, exempt from Indiana gross income tax.

STATEMENT OF FACTS

The taxpayer and subsidiaries, hereinafter "taxpayer", provides temporary employees through both company-owned offices and franchise agent offices. The temporary employees perform various services, including word processing, administrative and receptionist services, assembly line work, machine operation, packaging, inspection, and home healthcare services. The taxpayer is responsible for the payroll of all regular staff. In addition, the taxpayer is also responsible for the payroll of temporary employees. The taxpayer withholds and remits federal and state income tax and FICA, and pays federal and state unemployment tax and worker's compensation premiums on behalf of all regular staff and temporary employees.

The Temporary Employee Placement Process

The taxpayer procures temporary employees to fulfill the short-term labor needs of its clients. Clients utilize the taxpayer because the taxpayer provides administrative services such as employee recruitment and payroll, which would otherwise be burdensome for the client to perform on a temporary basis.

Because clients generally provide the taxpayer with minimal advance notice when requesting the services of temporary employees, the taxpayer maintains a list of potential employees who are qualified to meet the needs of its various clients. The taxpayer advertises in local newspapers and phone books to attract potential employees. The recruitment process generally involves completing a job application, conducting an interview, performing a skill evaluation, and checking references. If the taxpayer has a job assignment currently available that matches the applicant's skills, the taxpayer will offer the assignment to the applicant at the end of the interview. The applicant can either accept or decline this specific assignment, but can remain on the taxpayer's potential temporary employee list regardless of whether a specific assignment is declined.

In many cases, the interview is the only face-to-face contact the taxpayer has with applicants. The taxpayer generally contacts the applicants by phone to offer future assignments as openings become available. Nothing prohibits applicants from registering with multiple employment agencies; therefore, many applicants may have multiple registrations to increase the likelihood of finding employment.

When an applicant accepts an assignment, the taxpayer communicates the details of the assignment to the employee, such as the location, when the client expects the employee to arrive, and the estimated duration of the assignment. With the exception of payroll-related activities, this is the only interaction the employee has with the taxpayer. When an employee first arrives at the client site, there is a four-hour "test" period during which the client has the right to request another employee from the taxpayer. The taxpayer's standard Customer Service Contract, in part, states that, "[y]ou [the client] may direct us to replace any of our personnel assigned to you, in which event we will endeavor to promptly replace that person with another."

Right to Hire/Fire Employees and Duration of Employment

The taxpayer's applicants are not engaged for a job until a specific assignment is obtained. The taxpayer will not "hire" an applicant absent a specific assignment. Rather, the taxpayer retains all qualified applicants on its employee lists until assignments become available. Ultimately, the client has the authority to determine whether or no employees are retained on a job assignment and the duration of each job assignment. When an assignment is complete, the taxpayer no longer pays the worker because the client is no longer reimbursing the taxpayer for its procurement and paymaster services. In cases where a client is not using the services of an employee, the employee is considered unemployed

and the taxpayer may or may not retain the person on the applicant list until he or she is offered another specific temporary assignment.

Job Assignments/Instructions/Evaluations

Once the taxpayer assigns an employee to a client for a particular assignment, the client exercises complete and exclusive control over the employee's job responsibilities, and the client gives all instructions regarding how the job is to be performed. The client has the exclusive ability to evaluate the employee's performance and to decide whether to retain the employee based on this evaluation.

Supervision and Control

While on assignment, the employee is under the exclusive supervision and control of the client. The taxpayer's standard Customer Service Contract, in part, states that "[y]ou [the client] will **supervise, direct, and control** our personnel in the manner and method of performing their work" (emphasis added). As the contractual language makes clear, the taxpayer has no responsibility for the employee's day-to-day activities. The taxpayer merely procures the employee for its clients, who supervise and control the employees.

Office Space/Work Premises/Days and Hours

In all cases, the client provides the work space/premises where the employee performs his or her duties. Hence, it is the client who has the ultimate control of determining when and where the work is performed. Even in the home health care field, the taxpayer's client (the physician) controls which patients the temporary employee visits, and how often the temporary employee visits each patient.

Tools and Materials

The client generally provides all tools and other required materials, except in a few situations where the general business expectation is for the employee to supply his own tools and safety supplies. Some temporary employees may not have all required tools when first taking on an assignment. In this situation, the taxpayer may supply basic safety equipment such as back braces, goggles, and gloves in order to facilitate the hiring process. The employee generally pays for this safety equipment over a period of time.

Compensation

The taxpayer does not dictate the hourly wage of its employees. Based on job classification and local competition, the wage for each job is negotiated and agreed upon. Wages range from \$6 per hour for low-skill positions to \$40 per

hour for some high-skill employees. The taxpayer charges its clients the employee's hourly rate, plus a mark for the taxpayer's services. Clients can increase the employee's wage in order to retain the employee.

The taxpayer offers employee benefits to temporary employees, including vacation pay, health insurance plans, referral bonuses, 401(k), and an employee stock purchase plan. Historically, however, few temporary employees elect to take advantage of these benefits. In large part, the offering of these benefits to temporary employees hinges on conformity to applicable federal laws or employment conditions in very competitive markets.

Flow of Funds: Reimbursements

Employees keep track of the hours they work on a timecard provided by the taxpayer. At the end of each week, an authorized representative of the client signs the timecard for the employee, approving the number of hours reported to the taxpayer. The employee then generally faxes or mails the timecard to the taxpayer. Upon receiving the timecard signed by the client, the taxpayer pays the employee's wages, less appropriate payroll deductions. As previously stated, the taxpayer is responsible for reporting and remitting income tax withholdings on behalf of those employees. Additionally, the taxpayer pays state unemployment insurance contributions and workers' compensation premiums.

DISCUSSION

IC 6-2.1-2-2 provides that gross income tax is imposed upon the entire gross receipts of a taxpayer who is a resident or domiciliary of Indiana and the gross receipts derived from business activity within Indiana by a taxpayer who is not a resident or domiciliary of Indiana. Rule 45 IAC 1.1-6-10, however, states that income received in an agency capacity is excluded from gross income. Rule 45 IAC 1.1-6-10 further states that "A reimbursement of a taxpayer's own expenses are never excluded from gross income." Rule 45 IAC 1.1-1-2 defines an agent as:

- (a) "Agent" means a person or entity authorized by another to transact business on its behalf.
- (b) A taxpayer will qualify as an agent if it meets both of the following requirements:
 - (1) The taxpayer must be under the control of another. An agency relationship is not established unless the taxpayer is under the control of another in transacting business on its behalf. The relationship must be intended by both parties and may be established by contract or implied from the conduct of the parties. The representation of one (1) party that it is the agent of another party without the manifestation of consent and control

by the alleged principal is insufficient to establish an agency relationship.

- (2) The taxpayer must not have any right, title, or interest in the money or property received from the transaction. The income must pass through, actually or substantially, to the principal or a third party, with the taxpayer being merely a conduit through which the funds pass between a third party and the principal.

The Indiana Tax Court, in Policy Management Systems Corp. v. Indiana Department of State Revenue, 720 N.E.2d 20 (Ind. Tax Ct. 1999) and Universal Group Limited v. Indiana Department of State Revenue, 642 N.E.2d 553 (Ind. Tax Ct. 1994), has reviewed the issue of agency as it applies to gross income taxation. The Court echoed Rule 45 IAC 1.1-1-2 and Rule 45 IAC 1.1-6-10 by finding that an agency relationship includes consent by the principal, acceptance of authority by the agent and control of the agent by the principal. The Court, also, held that reimbursement of a taxpayer's own expenses is subject to gross income tax regardless of whether an agency relationship exists or not.

In the instant case, the relationship between the taxpayer and its client is not one of agent and principal, but rather, one of buyer and seller as the needed elements of consent, acceptance and control are lacking. Further, regardless of whether or not an agency relationship exists between the taxpayer and its clients, the reimbursement by the clients of the taxpayer's wages and taxes paid to, and for, temporary employees is reimbursement of the taxpayer's own expenses as the temporary employees, in fact, are employees of the taxpayer rather than the clients. The reimbursement of wages and taxes paid, therefore, is subject to Indiana gross income tax pursuant to the above referenced IC 6-2.1-2-2 and Rule 45 IAC 1.1-6-10.

RULING

The Department rules that the reimbursement of the taxpayer for wages and taxes paid to, and for, temporary employees by its clients does not represent income received in an agency capacity, hence, is subject to Indiana gross income tax.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. However, other taxpayers with substantially identical factual situations may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact

situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

Department of State Revenue